

**Update - Relocation Tax Issues – GRAB – May 25, 2005**

- New State Sales Tax Deductions\*
  - Affects mainly the *nine* “Non Income Tax States” AK, FL, NV, NH, SD, TN, TX, WA, WY\*

*\*Average lower gross-up amount of \$200 per move*
- New Lower State Income Tax Rate\*
  - DC from 9.30% to 9.00%
  - NM from 6.80% to 6.00%

*\*Average lower gross-up amount of \$150 per move*
- Temporary Assignments\*
  - Moves less than 1 year

*\* No gross-up required*
- Moves under 50 miles – Unqualified Moves\*
  - Home sale expenses are “**NOT**” taxable

*\* Average gross-up savings of \$12,000 per move*
- Multi-State Assignments\*
  - Temporary transfers to several different states within same year
  - *\* No* gross-up required
  - State Tax protection/equalization should be considered
- Number One Tax Gross-up/Assistance Cost Saving Measure implemented in past few years.
  - Do a year end true-up (Withholding vs. Gross-up) calculation.
  - Only pass Payroll negative adjustments while staying in compliance with Federal Supplemental withholding regulations.
  - Conforms with IRS code sections, 82, 217, 3401 and 3402. See IRS publications 521 and Publication 15 - Circular E.
- RITA Tables – Federal Register / Vol. 70, No. 49 / Tuesday, March 15, 2005 / Rules and Regulations
  - Several State tax rates listed that are not accurate.
  - In 2003/2004 the Federal rates listed where not correct. They did not take into consideration the retroactive nature of the JGTRRA signed into law by President Bush 5/28/03.
  - Impact was/will be “OVER Gross-ups”.
- Home Sale Prorated Capital Gains Exclusion
  - Exclusion amount of \$500,000 / \$250,000 is prorated if another move occurs in less than two years.

## Tax Tables

1/1/2005

	<u>2004</u>	<u>2005</u>
Value of Exemptions:	\$3,100	\$3,200
Child Tax Credit	\$1,000	\$1,000
Social Security (OASDI):	\$87,900      6.20%	\$90,000      6.20%
Medicare:	\$99999999      1.45%	\$99999999      1.45%
Supplemental Rate:	25%	25%
Mileage Factors	\$0.375 cents / \$0.14 cents	\$0.405 cents / \$0.15 cents

Standard Deduction:	<b>MFJ</b> \$9,700	\$10,000
	<b>MFS</b> \$4,850	\$5,000
	<b>HH</b> \$7,150	\$7,300
	<b>SNG</b> \$4,850	\$5,000

Phase out of Exmpts*:	<b>MFJ</b> \$214,050	\$218,950
For each \$2,500 that	<b>MFS</b> \$107,025	\$109,475
AGI exceeds the threshold,	<b>HH</b> \$178,350	\$182,450
2% of exmpt. value is lost	<b>SNG</b> \$142,700	\$145,950

Itemized Ded.Phout*:	<b>MFJ</b> \$142,700	\$145,950
* for each dollar that	<b>MFS</b> \$ 71,350	\$ 72,975
AGI exceeds the threshold,	<b>HH</b> \$142,700	\$145,950
3% of item. Ded. is lost	<b>SNG</b> \$142,700	\$145,950

## Tax Rates

				<u>Gup%</u>				<u>Gup%</u>
Marr. Filing Joint:	\$ 0 -	\$ 14,300	10%	11.11%	\$ 0 -	\$ 14,600	10%	11.11%
	\$ 14,300 -	\$ 58,100	15%	17.65%	\$ 14,600 -	\$ 59,400	15%	17.65%
	\$ 58,100 -	\$ 117,250	25%	33.33%	\$ 59,400 -	\$ 119,950	25%	33.33%
	\$ 117,250 -	\$ 178,650	28%	38.89%	\$ 119,950 -	\$ 182,800	28%	38.89%
	\$ 178,650 -	\$ 319,100	33%	49.25%	\$ 182,800 -	\$ 326,450	33%	49.25%
	\$ 319,100 -	+	35%	53.85%	\$ 326,450 -	+	35%	53.85%
Marr. Filing Sep:	\$ 0 -	\$ 7,150	10%	11.11%	\$ 0 -	\$ 7,300	10%	11.11%
	\$ 7,150 -	\$ 29,050	15%	17.65%	\$ 7,300 -	\$ 29,700	15%	17.65%
	\$ 29,050 -	\$ 58,625	25%	33.33%	\$ 29,700 -	\$ 59,975	25%	33.33%
	\$ 58,625 -	\$ 89,325	28%	38.89%	\$ 59,975 -	\$ 91,400	28%	38.89%
	\$ 89,325 -	\$ 159,550	33%	49.25%	\$ 91,400 -	\$ 163,225	33%	49.25%
	\$ 159,550 -	+	35%	53.85%	\$ 163,225 -	+	35%	53.85%
Head of Household:	\$ 0 -	\$ 10,200	10%	11.11%	\$ 0 -	\$ 10,450	10%	11.11%
	\$ 10,200 -	\$ 38,900	15%	17.65%	\$ 10,450 -	\$ 39,800	15%	17.65%
	\$ 38,900 -	\$ 100,500	25%	33.33%	\$ 39,800 -	\$ 102,800	25%	33.33%
	\$ 100,500 -	\$ 162,700	28%	38.89%	\$ 102,800 -	\$ 166,450	28%	38.89%
	\$ 162,700 -	\$ 319,100	33%	49.25%	\$ 166,450 -	\$ 326,450	33%	49.25%
	\$ 319,100 -	+	35%	53.85%	\$ 326,450 -	+	35%	53.85%
Single Rates:	\$ 0 -	\$ 7,150	10%	11.11%	\$ 0 -	\$ 7,300	10%	11.11%
	\$ 7,150 -	\$ 29,050	15%	17.65%	\$ 7,300 -	\$ 29,700	15%	17.65%
	\$ 29,050 -	\$ 70,350	25%	33.33%	\$ 29,700 -	\$ 71,950	25%	33.33%
	\$ 70,350 -	\$ 146,750	28%	38.89%	\$ 71,950 -	\$ 150,150	28%	38.89%
	\$ 146,750 -	\$ 319,100	33%	49.25%	\$ 150,150 -	\$ 326,450	33%	49.25%
	\$ 319,100 -	+	35%	53.85%	\$ 326,450 -	+	35%	53.85%



## Relocation Taxation Basics – 2005 Tax Year

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### Purpose

This paper discusses the taxation basics of relocation-related expenditures and the tax consequences thereof for individuals relocating their family and personal belongings at the request of their employer.

### Overview

An organization may relocate, or move, an employee to fill an open position in another location that otherwise may not have local candidates and/or any qualified personnel to adequately meet the requirements for that position. The company may provide the employee (transferee) with benefits to help offset the costs associated with the relocation through the company's relocation policy. These benefits may be taxable to the transferee when paid by the company either directly to the transferee or on behalf of the transferee to a service provider.

### Relocation Qualification

Certain relocation-related expenditures may be deductible based on to the qualification of the relocation. IRS Publication 521 – Moving Expenses clarifies this qualification using three tests: 1) Related to Start of Work; 2) Distance; and 3) Time. In meeting all three of these tests, transferees may deduct (or have excluded from income by their employer) several relocation expense types as discussed in Relocation Expenses later in this paper, which reduces the tax burden to the transferee as a result of relocating.

#### Related to Start of Work Test:

A transferee must relocate to the new location within one year from the date he/she first reported to work unless reasonable circumstances prevented the transferee from meeting this time frame. Such circumstances would include allowing a child to complete high school. As a rule of thumb for such exceptions, the move should be completed within two years to meet the qualification tests.

#### Distance Test:

The transferee's travel distance to the new job location must increase at least 50 miles from the current home in comparison to the distance from the current home to current job location. This distance is calculated along the most direct travel route.

#### Time Test:

The transferee must work full-time for at least 39 weeks during the first 12 months after arriving in the new location.

### Relocation Expenses

Relocation expenses are categorized into several taxation categories. These categories and the corresponding expenditures include:

#### *Non-Taxable/Excludable*

Such expenses are reimbursed directly to the transferee and are reported on the transferee's W-2 Form in Box 12, coded with a "P".

- Shipment of household goods and pets
- Any period of 30 consecutive days of storage for personal belongings for domestic moves, whereas for international moves, there is no limit on the days of non-taxable storage
- Travel and lodging expenses for the final trip and en route costs (via the most direct route) to the new location for the transferee and his/her relocating family members
- For 2005, the first \$0.15 per mile for personal car mileage – this rate may change annually or more frequently

## ***Relocation Taxation Basics – 2005 Tax Year (continued)***

### ***Non-Taxable/Business Excludable***

These expenses follow the **Non-Taxable/Excludable** expenses noted above except are paid to a service provider or vendor on the transferee's behalf by the company. Such expenses are not reported on the transferee's W-2 form but continue to be reported by the employer on IRS Form 940.

### ***Non-Taxable/Non-Reimbursed***

Non-Taxable/Non-Reimbursed expenses follow the two categories above but were not reimbursed by the company. In this event, the transferee may file IRS form 3903, with his/her Federal tax return to claim these expenses as a direct reduction of income on line 27 of the Federal tax return (form 1040).

### ***Non-Taxable/Business***

Employee business expenses paid by the company are not generally considered taxable. However, if a spouse or other individual accompanies the employee on a business trip and these expenses are reimbursed, the non-employee expenses would be considered taxable income to the employee. In addition, expenses associated with the sale of the transferee's home (Revenue Ruling 72-339), when handled in accordance with the Employee Relocation Council's (ERC) Eleven Key Elements and Procedures for Amended Value Option, could be considered business expenses and not taxable to the transferee nor added to his/her W-2 form. The Amended Value process is currently under review by the Internal Revenue Service for compliance. A field paper has been published but no guidance has been issued by the IRS as of yet.

### ***Taxable/FICA-Only***

Expenses in this category are those that are federally deductible (Schedule A) by the transferee when filing his/her Federal tax return form 1040. These expenses are also deductible in all but 10 states (Connecticut, Illinois, Indiana, Massachusetts, Michigan, New Jersey, Ohio, Pennsylvania, West Virginia and Wisconsin [Wisconsin allows a 5% credit]) with the exception of the states, which have no state income taxes. These expenses must be reported in boxes 1, 3, 5, 16, and 18 (if applicable) of the transferee's W-2 as taxable income when paid by the employer even though they are deductible. The employer may choose whether to tax assist these expenses or not as a part of the relocation benefit. However, these expenses are fully taxable for all taxing authorities at the time of payment as noted in IRS Publication 15 (Circular E) for payroll purposes. These expenses include:

- Mortgage Points and Interest – (HUD-1 Form Lines 801 & 802)
- Mortgage Interest Differentials
- Real Estate Taxes

### ***Taxable***

All other expenses are considered taxable to the transferee and must be imputed as income to his/her W-2 form, boxes 1, 3, 5, 16 and 18 (if applicable) in the tax year in which they were paid. These expenses create the most significant tax burden to the transferee. The employer may choose to offset this tax burden with an additional benefit "tax assistance" which, itself, is also taxable to the transferee. Taxable expenses should be reported as income to the transferee, in the pay period in which they were paid, and taxed accordingly for all taxing authorities. These expenses include:

- Travel, lodging and meal expenses when searching for a new home
- Lodging and meal expenses incurred during the interim period when a new home has not been found and after the transferee has started work in the new location
- Return trips to the old location after starting the new job
- Meals during the final trip to the new location
- Closing costs for the new home
- Lease breaking costs and costs associated with finding a lease in the new location
- Closing costs on the prior location home when the expenses are directly reimbursed to the transferee or the home sale program does not conform to the ERC Eleven Key Elements
- Non-receipted lump sums
- Tax Assistance
- Final trip car mileage reimbursement in excess of \$0.15 per mile

## ***Relocation Taxation Basics – 2005 Tax Year (continued)***

### **Payroll Withholding**

Relocation expenditures are taxable in the pay period in which they are paid and payroll taxes must be withheld (IRS Publication 15-Circular E). These taxes may be offset or paid by the employer on the transferee's behalf (tax assistance) or withheld from the transferee's reimbursement amount. At a minimum, a "supplemental" amount of tax must be withheld for Federal withholding purposes. The Federal supplemental tax rate is 25% of the total taxable amount (35% for employees with supplemental payments in excess of \$1,000,000).

States may also have a supplemental tax rate. For example, California has a schedule of tax rates ranging from 0 to 10.3% of taxable income. The California supplemental tax rate is 6%. However, in the state of California, if a company reports this taxable income as bonus wages rather than supplemental wages, the withholding rate must be increased to 10.3% (this applies only to California at this time).

Social Security (OASDI) and Medicare taxes must also be withheld at this time. Social Security must be withheld at a flat 6.2% of taxable wages through \$90,000 (for 2005) of earnings. Likewise, Medicare must be withheld at a flat 1.45% of all taxable income without limit.

### **Tax Assistance (Gross-up)**

Where payroll withholding is a requirement at the time of payment with specific minimum withholding requirements, **Tax Assistance** is not a requirement and, if provided by the employer, may be calculated in any way that suits the company's requirements. However, it should be noted that this tax assistance is also taxable and must be included in the transferee's wages. Several common calculations include:

#### *Flat Rate*

This calculation provides a flat rate percentage of the taxable payment to assist in offsetting the tax burden. It may or may not cover the transferee's entire tax liability as a result of the relocation payments. The calculation is as follows where the employer as part of policy selects the tax assistance rate:

Taxable Amount of Expense	\$1,000
Tax Assistance (20% tax assistance rate)	<u>\$ 200</u>
Total Taxable Wages	\$1,200
Less: Payroll Withholding (25% Federal)	\$ 300
Payroll Withholding (3% IL State)	\$ 36
Payroll Withholding (6.2% OASDI)	\$ 74
Payroll Withholding (1.45% Medicare)	<u>\$ 17</u>
Net Payment	\$ 773

In the example, the transferee shared in part of the relocation tax burden in the amount of \$227 whereas the employer contributed \$200 towards the total tax requirement of \$427.

#### *Inverse Rate*

This calculation provides a tax-on-tax rate calculation of the taxable payment to assist in offsetting the entire tax burden at the time of payroll withholding. The calculation is as follows where the employer selects the tax rate:

Taxable Amount of Expense	\$1,000
Tax Assistance (55.4% tax assistance rate)	<u>\$ 554</u>
Total Taxable Wages	\$1,554
Less: Payroll Withholding (25% Federal)	\$ 389
Payroll Withholding (3% IL State)	\$ 47
Payroll Withholding (6.2% OASDI)	\$ 96
Payroll Withholding (1.45% Medicare)	<u>\$ 22</u>
Net Payment	\$1,000

In the example, the employer paid the entire payroll withholding tax burden including the withholding required for the tax assistance amount. The 55.4% tax assistance rate is calculated as:

$$\text{Sum of tax rates} / (1 - \text{Sum of tax rates}) \text{ Or } 35.65\% / 64.35\% = 55.4\%$$

This method is commonly used to offset the total relocation tax liability while meeting the payroll withholding minimum requirements. However, it should be noted that this method may cause the transferee to receive a tax refund or tax shortage when filing the Federal and/or State tax returns as the transferee will be able to deduct from taxable income the standard deduction (at a minimum) and may be able to itemize their Federal tax deductions allowing them to deduct the state gross-up including all state withholding dollars placed in W-2 Box 17 as well as family exemptions to reduce the actual taxable income, possibly moving the transferee into a different tax bracket above or below the 25% income tax bracket. Additionally, when filing their State tax returns, many states allow the Federal gross-up paid by the company including all Federal withholding included on the W-2 in Box 2 to be deducted. As a result, a true-up or year-end adjustment may be applied.

The true up is an additional year-end calculation to assist the employer in recouping any overpayment of tax gross-up or assisting the transferee further when a shortage of taxes occurred as a result of relocation. To accommodate this difference, a recalculation may be conducted using the transferee's real tax filing information including exemptions, standard or estimated Schedule A deductions and total company income both with and without the taxable relocation expenses to determine the difference owed to/from the transferee. If an additional amount is calculated and the company decides to pay this excess, it should be noted that this additional tax assistance amount is also taxable and a tax-on-tax calculation may, again, be incorporated.

### **Conclusion**

Most relocation-related expenses paid by an employer are considered taxable income to the transferee and should be imputed to the transferee's wages as income. The information discussed in this paper is general in nature and exclusions to one or more of the discussion topics do exist. A more in-depth discussion to identify these exclusions may be necessary and/or additional documents may be required.